THE

RIGHTS AND WRONGS

—OF—

HELPLESS STOCKHOLDERS

AND OF A

HELPLESS CORPORATION.

Thou shalt not covet thy neighbor's house; thou shalt not covet thy neighbor's wife, nor his man-servant, nor his maid-servant, nor his ox, nor his ass, nor anything that is thy neighbor's.—*The Decalogue.*

The attempt and not the deed confounds us.—*Lady Macbeth.*

BY A LAYMAN.

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PREFACE.

The following pages are dedicated to stockholders generally, and more particularly to the common stockholders of the St. Paul and Duluth Railroad Company.

The wrongs complained of are such as could be remedied only by an appeal to the Courts. That appeal has been made, and will be prosecuted till it is judicially settled whether or not the control of Directors exonerates them from all liability to the corporation or the stockholders for unlawful acts, and whether the positive duties of trustees can be successfully evaded under the pretense that they are merged in the discretionary power of Directors.

NEW YORK, April 10th, 1887.

THE

RIGHTS

— OF —

HELPLESS STOCKHOLDERS.

THE judicial current for many years set very strong in favor of recognizing in Directors of corporations a power the Court would not disturb. The inclination has been to leave them in the hands of the stockholders, and to give the stockholders no other remedy for any wrong than such as they could derive from a change of their agents. But cases came before the courts in which complaining stockholders had no voice in the choice of Directors. It was impossible for them to change their agents. The question then arose whether there were wrongs incapable of remedy, and the judicial current changed.

The present inclination of courts is to confine within legal boundaries and limitations the control vested in Directors; to recognize more distinctly and more largely than heretofore the rights of the individual stockholder, and to aid his assertion of them. The Supreme Court of the United States has given expression to this sentiment when it repudiates the idea that illegal transactions of Directors can be regarded as "condoned" or "legalized" because

"helpless stockholders," who could not change the Directors, have failed to "undertake the burden of such gigantic controversies as are involved in the railroad transactions of the present day." Instead of perilling their rights, their "helplessness," in the judgment of the court, only aggravates the wrong. The Supreme Court has thrown out the signal, and the Circuit and District Courts have taken note of it, and many recent cases show a judicial determination that the "control" of Directors must be strictly exercised within the law and within the charter.

The recent valuable work on the law of stock and stockholders, by Mr. Cook of the New York bar, devotes an important chapter to the Frauds of Directors in corporate institutions, and more particularly in railroad companies. Of latter years, he says, the highest talent has been employed in the spoliation of corporations and stockholders, sometimes by the old and familiar methods of fraud, but more frequently by the invention of new methods, such as undue increase of dividends, the payment of unearned dividends, the arbitrary withholding of dividends that are fairly earned, the use of corporate income for improvements, whereby dividends are cut off until the managers have purchased all the stock they want at prices far below the real value. This writer devotes a pregnant paragraph also to the frauds practised by a majority of stockholders on the minority, by exercising their "control" otherwise than in the "utmost good faith," as by conspiring to compel a minority, with different interests, to consent to fundamental changes in their charter, and the surrender of a large and valuable portion of their property as

the inexorable condition of being permitted to enjoy the beneficial use of the remainder.

These topics are all illustrated in Mr. Cook's interesting volume with much acuteness of analysis and a large citation of authorities.

It is my purpose in the present essay to show that all these methods figure more or less in the history of the St. Paul and Duluth Railroad Company. I shall also endeavor to show that methods not mentioned in the above enumeration, but entirely novel and unprecedented, have been so practised by the managers of that corporation as to fully entitle them to the credit of all the subtlety, enterprise and audacity which Mr. Cook ascribes to the most finished achievements in this department of industry.

The St. Paul and Duluth Railroad is an outcome from the reorganization of the Lake Superior and Mississippi Company, which at the time of its failure had outstanding $4,492,000 first mortgage bonds and $3,200,000 second mortgage bonds, besides notes and certificates which had been given for money borrowed to pay previously maturing coupons and for floating indebtedness. All these obligations represented money that had been put into the road, to aid in the construction of which a large land grant had been made by the United States and the State of Minnesota. In order to procure the necessary legislation, to quiet opposition, and to preserve the integrity of the enterprise it was indispensable to provide equitably for the junior securities and to do something, however inconsiderable, for the $5,000,000 of common stock. The old road, therefore, was foreclosed under an agreement that merged all pre-exist-

ing rights and interests in a plan of reorganization, that was made the charter of the St. Paul and Duluth Railroad Company. To this Company the original stockholders of the old corporation were admitted on the basis of one new share for every twenty old shares. Thus it will be seen that the entire stock to be issued to the new Company substantially represented actual cash paid up, for it is not to be supposed that the original stockholders obtained their franchise without an expenditure of time, labor and money.

Without regard to the name by which they were designated, and with no implication whatever of any superior equities in one class over the other, a binding agreement was made between the two classes of stockholders, by which certain rights and interests, clearly defined and intended to be strictly secured, were severally assigned to the two contracting parties. It was a perfectly fair covenant. No advantage could have been taken of either side. We may suppose that the first mortgage bondholders had a paramount influence in framing it; but even at that time it was a question with those who believed in the future of Duluth which class had the better end of the bargain.

This plan vested in the so-called preferred stockholders a lien on the property, to the extinguishment of which the net proceeds of the land grant and the surplus profits of the railroad, after the payment of seven per cent. on the preferred and six per cent. on the common stock were set apart and devoted.

The reorganization was finally completed on the 27th of June, 1877, by the due promulgation and cer-

tification of the plan. There was also filed in the proper office of Minnesota, of the same date, a certificate setting forth the due formation of the new organization, its corporate name, the amount of its capital stock, the number of preferred and the number of common shares, with the names of the officers of the Company, and the number and names of the Directors, and the fact that none of the common stock had been issued. So the officers and Directors were first appointed without the intervention of the common stockholders, who have remained without a representative or any voice or influence in the Board from that day to this. It was by the preferred stockholders, therefore, and for their benefit and protection, that it was recited in this certificate that the 60,000 shares of preferred stock are "allowed to be used in the purchase of and payment for lands of said company, as in said agreement in that behalf provided, each share thereof, UNTIL *so converted or used in such purchase of land, to be entitled to one vote*, in the election of Directors and in other proceedings and meetings of stockholders."

This certificate, required by the laws of Minnesota, and forming an essential part of the charter, explains itself. It leaves no room to doubt the unavoidable inference from the agreement that the preferred shares authorized to be used in the purchase of lands *as* the "first mortgage bonds now are"—like the first mortgage bonds, when received, were to be cancelled and incapable of reissue under any circumstances. It was impossible to reclothe them with the voting power which terminated absolutely when they were so converted and used. To this very important cer-

tificate I shall have occasion to refer in another connection.

It will be instructive, before proceeding to other topics, to consider the condition of the property of the St. Paul and Duluth Company at the time of the reorganization and the four years thereafter. This property, constituting its capital, represented by the number of shares authorized to be issued for the purposes named in the plan, consisted of two parts—a grant of lands and a railroad. The grant of lands was specially set apart, as it ought to have been, for the redemption and liquidation of the preferred stock, as representing the original mortgage bonds, from which the first money had been derived that was used in the construction of the road. This was a use entirely consistent with the objects of the grant of Congress. Its use for the liquidation of imaginary profits and unearned dividends was never contemplated.

We have the materials, fortunately, for a very full account of the status of the railroad at the period of which we are speaking. It is to be derived from the copious memoirs by which the first Vice-President of the Company, still in office, has illustrated various stages of its history—by the facts stated in the opinion of Judge Drake—in this connection a very valuable contribution to the controversy; in the reports of the Company; in the clear and conclusive letter addressed to the common stockholders by Mr. John P. Ilsley, the first President of the Company; and above all in the answer of the President and Directors to the first bill of Mr. Baring-Wells. Making intelligent use of these sources of information

we may derive all the facts important for our consideration.

First let us look at the account given in the *Railroad Record* of Philadelphia, which we are informed was written or dictated by the management of the Company as represented by the Vice-President. We are told that at the time of reorganization the St. Paul and Duluth was—

"A worn-out road, with little equipment of its own, and no adequate terminal or other facilities for doing the little business it had, which was not sufficient to pay operating expenses and put and keep the property in proper repair. After an almost hopeless struggle of four years, during which *all the earnings from the railroad and income from land and stumpage sales had been spent*, and a floating debt of $600,000 had been incurred in the effort to operate the railroad and improve the property, the stockholders, by a unanimous vote of more than two-thirds of each class of stock, authorized a loan of $1,000,000 on first mortgage bonds, and a settlement with the preferred stockholders for *dividends due* them to July 1st, 1881, from income which had been expended upon the property. The $1,000,000 was borrowed, and the floating debt was paid, and a dividend of ten per cent. in preferred stock, amounting to $470,560.69, was paid to the preferred stockholders. The entire main track was now being relaid with steel, and the funds on hand, with the earnings, were still inadequate to carry on this and other improvements imperatively demanded, without a further application of the *income from land and stumpage sales due the preferred stockholders in dividends;* therefore, at their annual meeting in June, 1884, the stockholders, by a vote of more than two-thirds of each class of stock, unanimously authorized a dividend of 7 per cent. in preferred stock to the preferred stockholders in lieu of the *cash due them*, but which had been expended upon the property, which dividend amounted to $350,000. All other dividends due on the preferred stock, amounting to $1,270,997, have been paid in cash. There was $5,550,090.02 preferred stock and scrip issued in the organization of the Company, and $820,763.69 subsequently in

dividends, and there has been $993,883.11 cancelled, leaving $5,376,970,60 now outstanding, a reduction of $173,119.42 from the original amount issued."

In the memoirs to which we have referred these statements are frequently repeated in nearly the same language, and always with the refrain, "*Cash dividends due the preferred stockholders for their money spent on the property.*"

In another place the same story is told, with some verbal changes. "Under the plan," the management say, "the proceeds of lands and stumpage were *first* to be applied to making up the dividends of 7 per cent. on the preferred stock, but it became necessary some years ago for the *protection of the line from decay, to save the life of the Company and its charter in fact*, to expend some of these proceeds due the preferred stockholders upon the property." And then follows the old story of the stockholders of both classes "unanimously" doing this, that and the other.

In this narrative the situation of the road and the circumstances attending the issue of dividends in preferred stock are so blended that it is difficult to separate them. I shall continue, therefore, to treat them in connection, and proceed to cite Judge Drake's account of the matter printed in the *Railroad Record*, with the well-merited description of its author as one of the ablest and most distinguished jurists of the country. In accounting for the increase of the preferred stock the distinguished jurist says: "This is explained by the fact that, on two occasions, the stockholders at their annual meeting authorized

the issue of additional preferred stock to preferred stockholders in payment of dividends to which they had become entitled, but which were not paid to them because the income of the Company was *indispensably needed to put and keep the road in a proper condition to meet the demands of its business.*"

These narratives are interesting and conclusive, though they are not made under oath. But I will now beg my readers to consider with attention what the Directors have sworn to in their answer to the first bill of Mr. Baring-Wells. They swear that at the time of reorganization it was understood by all the parties in interest:

"That said property [meaning the railroad] needed large expenditures for replacements and repairs and additional rolling stock, and further that it was incumbent upon the successors of said corporation [meaning by said corporation the Lake Superior and Mississippi Company] who would be bound to provide for the regular transportation of the mails of the United States, and to provide from time to time for the transportation of all freights and passengers that might be offered for transportation, as well as freight from other connecting roads destined to points upon said railroad; and so manage, provide and control said property as promptly, fully and safely to perform all its duties and obligations to the public, and *that all the expenditures necessary for the purposes aforesaid must be provided for out of the income from said railroad and property;* and further understood that no agreement between the bondholders, stockholders or other parties interested could be legally made that would divert said earnings and income necessary for the purposes aforesaid."

Coming down to the great settlement of 1881, the Directors swear that the issue of $1,000,000 bonds in that year was made for the express purpose of making repairs, replacements and providing additional

rolling stock, and that they necessarily expended six hundred and eighty-eight thousand five hundred and fourteen dollars and forty-nine cents—exactly—in paying the accrued floating indebtedness of the corporation. These expenditures were all made necessary by the "dilapidated condition" in which they received the property.

Keeping in view the facts thus sworn to by the Directors let us consider for a moment their account of the issue of cancelled preferred stock in the way of dividends from "net income." The trustee corporation thus deposes:

"The defendant admits that the holders of the preferred stock allowed the Board of Directors to use in necessary improvements a large amount of the money otherwise payable to them in dividends, and agreed to capitalize the same, and that the scrip or additional preferred stock stated in said complaint was so issued, and avers that the said issue and the capitalization thereof, and all and singular the acts and doings of the Board of Directors relating thereto, was, at the regular annual meeting of the stockholders, preferred and common, of the defendant corporation, duly notified, organized and held on the 20th day of June, A. D. 1881, ratified, approved and confirmed."

Of the stock dividend of 1884, the answer has nothing to say, and I shall dispose of the first stock dividend before it will be in order to speak of the second.

During this period of dilapidation and decay, replacement and repair, in the railroad, the parties in possession of the secrets and the property of the company had not been slow in availing themselves of that provision of the plan which authorized the conversion of the preferred stock into the lands of the

company. This industry had been persistently pursued during the four years in which the railroad was "struggling for life." The most valuable timber lands of the Company were secured by the preferred stock at prices fixed by the preferred stockholders themselves. By whom, or for whose benefit, these lands were acquired may be an interesting subject of future inquiry. I will not interrupt our present study by entering on this new field of speculation.

From these authentic sources we learn beyond any doubt that for the first four years after the reorganization in 1877, the road was in such a dilapidated state that it took every dollar the corporation could rake and scrape to enable it to do any business whatever. Not only did it take every dollar received from the road and the land grant, but a floating debt had been incurred of $688,514.49.

Meanwhile the landed capital stock had been largely diminished by the absorption of the lands by the preferred stockholders, as provided by the charter.

When the Directors came together in 1881 they found this state of things existing, and the conundrum was, under the charter, to find "net profits" from the railroad and "net income from the stumpage and the sale of lands" to figure up a dividend on the preferred stock. They ought to have figured it in this way;

Minus on the railroad	$688,514 49
Minus on the landed property	844,000 00
Minus altogether	$1,532,514 49

The algebraic problem was how from two minuses to evolute a plus.

It dawned upon the Directors that by pooling their debts, with the evidences that they had parted with the landed property of the corporation to a large amount, they could convert them both into net income, accruing to the preferred stockholders.

So in this roseate view of the situation the Directors applied to the preferred stockholders for "permission" to make believe that the debts they owed were net profits, and that the preferred certificates, which the corporation had once satisfied, either in land or in money, still constituted valid claims against the corporation.

After swearing to facts which prove conclusively that there was not a dollar in the treasury applicable to dividends on the preferred stock—unless floating debts can be so described—and after swearing that a large amount of preferred stock had been satisfied in land and cancelled, the corporation defendant in effect says, that it "capitalized" its "debts" in satisfied and cancelled stock, and by distributing it among the preferred stockholders succeeded in imposing on itself *the necessity of satisfying and cancelling it a second time.* Very improvident management in a corporation one would naturally think.

Let us now consider very briefly the legal conditions that are necessary to the declaration of a dividend. The charter of the St. Paul and Duluth Company says in regard to dividends that they shall be made payable out of the "net profits" of the railroad, and the "net income" from stumpage and the sale of lands. It is familiar law that the dividends of corporations can be paid only from net profits, but I am writing for the average stockholder who is not

supposed to be familiar with the law. Morawetz, in Section 435 of the first volume of his excellent work on private corporations, states the proposition thus: "It is a fundamental rule that dividends can be paid only out of the profits or the net increase of the capital of a corporation, and cannot be drawn upon the capital contributed by the shareholders for the purpose of carrying on the Company's business." In his very practical and useful work on the law of stock and stockholders, Cook says, in Section 539: "A dividend can *lawfully* be made only out of net profits. The payment of it must leave the capital stock of the Company intact and unimpaired, or it will be held fraudulent and void." The cases cited to this proposition I have examined with care and they fully sustain it.

The Directors and Trustees of the St. Paul and Duluth Company knew of this rule of law, and proved themselves adequate to its exigencies. With the use of their proxies they appointed the proper committee at the annual meeting of the stockholders in June, 1881, and obtained from this committee the report that the *net income* of the Company from June 27th, 1877, to July 1st, 1881, had reached the enormous sum of $1,378,922—one million three hundred and seventy-eight nine hundred and twenty-two dollars. What wonder that on the announcement of such a bonanza the common stock should have gone skyward! And who could blame Mr. Baring-Wells, an English gentleman recently arrived on our shores, for investing in it at forty dollars a share. The good Directors now say that it was not worth that much in 1881—that its rise was owing to "speculation"—and

that "speculation" was based, no doubt, on this extraordinary statement of its "net income." My authority for this statement is the very timely and able letter of Mr. John P. Ilsley, formerly President of the St. Paul and Duluth Railroad Company, addressed to the holders of its common stock in 1886.

This being so—it would seem hard that the preferred stockholders should not have had some dividend—if there was anything to pay it with. A "net income" approaching a million and a half of dollars—and not a picayune in the treasury! But the corporation "owed" a large amount of money to the preferred stockholders "for their money spent on the property." Now the preferred stockholders were not *creditors* of the Company. Nothing whatever could possibly be *due* to the preferred stockholders till the Directors declared a dividend lawfully from "net income." Why, the Company was really indebted to *bona-fide* creditors in the sum of nearly $700,000. If there had been any money earned in any way over and above expenditures absolutely necessary to keep its life in the charter—to save the life of the road—to put it into a condition capable of doing any business whatever—that money was "due" not to its preferred stockholders but to its creditors.

What did the corporation possess at that time, out of which it could have lawfully made a dividend? How could the corporation have possibly figured out that it owed the preferred stockholders $470,560 for *their money expended on the property?* From what quarter could the corporation have possibly derived a "net income" when it consumed every dollar of its earnings from the railroad in absolutely indispensable

operating expenses? The total net cash *receipts* from both railroad and land grant up to July, 1881, amounted only to about $700,000, and those receipts had all been expended and the Company still owed nearly $700,000. Whose money paid that debt? The money of the preferred stockholders? Not a dollar of it. That was all paid by borrowed money, realized from the million of 5 per cent. bonds, which from the start have been and now are a charge on the common stockholders alone. The preferred stockholders have never contributed one dollar to either principal or interest.

It must be admitted then that the corporation had no net income, or profits, or cash earnings, lawfully applicable to dividends on any stock. But how is it with the "net increase" of the capital stock? You will remember that Morawetz says you may make a lawful dividend out of the net increase of the capital stock. Did this corporation exhibit any such net increase? Its *landed capital* had been exhausted to the extent of $884,000 by the redemption of preferred stock to that amount.

There was no increase of capital in that direction, but a loss of capital. Suppose that the railroad capital had been increased to that amount, then it would have just balanced the loss of landed capital, and there would not have been a dollar to divide. But we know that the only portion of the increase of railroad property that could have furnished the basis of any dividend at all was derived from the proceeds of a loan of a million of dollars, the sole burthen of which was imposed on the common stockholders.

The "Paternal Government," however, has a theory

upon this subject. It would be amusing if it were not so amazing. The $844,000 of cancelled preferred stock was in the hands of the Directors, and *that* they determined was the cash of the preferred stockholders spent on the property, though the preferred stockholders themselves had actually received $844,000 worth of the very best lands of the Company for that very stock. Are there any circumstances under which you can satisfy a lien on property out of the property itself and then lawfully reissue the satisfaction piece, or a substitute for the satisfaction piece, as a new lien on the *remainder* of the property? That you can do no such thing lawfully is a proposition too plain for argument. If the corporation could have reissued its cancelled stock once, it could have reissued it twice, or as many times as might be desirable. By this process it would only have been necessary to apply earnings to improvements and additions with their present energy and vigor, and in much fewer years than it would take to extinguish the preferred stock, the preferred gentlemen would have acquired all the lands of the Company, and even made a better thing of it than by voting themselves three-fifths of the property.

And at this point it is well enough to allude to the dividend contemplated by the plan. These preferred stockholders are in the habit of talking of "their" 7 per cent. dividend as "due," whether earned or not, as if they were creditors of the Company instead of being its stockholders. Judge Drake in his now famous opinion speaks of the "7 per cent. dividend to the preferred stockholders *provided for in the plan.*" There was no such dividend provided for.

When there was no net income there was no dividend payable under the plan. But however large the net income, the dividend never could exceed 7 per cent. It might be less. It might be nothing. Now the statement of the defendant corporation is that in the year 1884 they did not have the "net income" from which to pay the 7 per cent., so they divided *that year* 10½ per cent, It is not so stated in the annual report of 1884, which gave the stockholders all the information they had on the subject. The railroad income account in the report of that year thus states the dividends then paid:

Stock Dividend, payable July 1st, 1884.....	$350,000 00
Cash Dividend No. 6, payable January 1st, 1885..	187,092 50

This conveys, and intentionally, the idea that the only dividend paid in 1884 was the 7 per cent. in stock, a mode of payment utterly unwarrantable, even if there had been any dividend due when the "net profits" were not sufficient to warrant it. If there were "net profits," why was not the dividend paid out of them? If there were no "net profits," which is the theory, why was not the dividend limited as the plan limits it to such a dividend as the "net profits" could pay?

Such is the statement of dividends made in the annual report, and I for one stockholder never knew, till I saw the exhibit annexed to the answer of the defendant corporation, that cash dividend No. 6 was not payable January 1st, 1885, but was paid in addition to the stock dividend in 1884, numbers 7 and 8 being paid in 1885. This made the dividend of 1884 10½ per cent., while the Plan expressly pro-

vides that in no year shall the preferred dividend exceed 7 per cent. In this year, then, not only did it exceed that sum, but 7 per cent. of it was paid in a manner utterly unwarranted and unlawful. It was unlawful in manifold senses—first, as it was an issue not authorized by the plan; secondly, because it could in no wise be called "net profits," from which alone the Directors could declare dividends; thirdly, because it was an over issue of stock not authorized by law; fourthly, because it was a reissue substantially of a stock mortgage, which had been once satisfied and cancelled, and could not again be made a charge on the property, without practicing a fraud on the first mortgage bondholders, the public and more particularly the common stockholders. We have the formal registered certificate to show that stock converted into lands was no longer to have a vote or a voice in the management of the Company. This stock has been reissued and illegally voted in favor of all the acts by which the common stockholders have been defrauded. At the next meeting of stockholders of course the Directors will be called upon to identify such stock and prevent its casting unauthorized votes.

Now, what is the answer to all this? So far as the issue of 1884 is concerned there is no answer. With regard to the first stock dividend of 10 per cent. it is averred that all the proceedings of the Directors in the premises were, at a regular meeting of the stockholders duly notified, organized and held on the 20th day of June, 1884, "ratified, approved and confirmed." How much is there in this averment of ratification?

It is text-book law, confirmed by so many authorities that reference to them is unnecessary, "that an act which is in excess of the charter of a corporation involves an unauthorized exercise of corporate power on the part of the Company; and this objection cannot be obviated by any subsequent ratification by the agents or the shareholders of the corporation. So it is clear that, if an act performed by an agent on behalf of the corporation is prohibited by statute, or by the charter of the Company, or by some general rule of the common law, no ratification by other agents or the shareholders of the Company can cure the illegality of the act." See Morawetz, § 619, and the cases cited in the note thereto.

There are unquestionably many unauthorized acts of Directors which stockholders may ratify, and which the slightest evidence of ratification would be sufficient to sustain. All mere informalities otherwise invalidating corporate acts would be cured by acquiescence or a failure to enter an objection on the spot. Corporate business could not be managed on any other basis, but it is entirely different with acts that are unlawful, with acts that may affect the public injuriously or are against public policy, or with acts that are in violation of a charter. Such acts as are here described may be "approved" by stockholders who profit by them, but they are incapable of "ratification" even by the real, and certainly not by the merely "constructive," unanimity of stockholders.

Suppose for a moment that these unlawful acts of the Directors were capable of ratification, upon what conditions must such ratification rest? In the first place there must be a full knowledge on the part of the

stockholders of the transaction which was in excess of the power of the Directors (*Evans* vs. *Smallcombe, L. R, H. of L.*, 249). The ratification must be a deliberate act; it must be untainted with any suppression of truth or suggestion of falsehood; the ratifying party must be aware of the fact that the transaction was of such a nature that it could be impeached in a court of equity (*Lewin on Trusts, affirmed in Cumberland Coal Co.* vs. *Sherman*, 30 *Barb.*, 553). Ratification must be founded on complete information, perfect freedom of volition, and a knowledge on the part of stockholders of their equitable rights (*Hoffman, &c., Co.* vs. *Cumberland, &c.*, 16 *Md.*, 456). All the material facts and circumstances calculated to influence the mind of the stockholder must be known to him to make any alleged ratification an estoppel (*Gilman, &c., R.R. Co.* vs. *Kelly*, 77 *Ill.*, 426). Where an act is manifestly to the injury of the corporation there must be clear proof of ratification (*See Morawetz*, § 629). Equally true it must be that when an act is manifestly injurious to a particular class of stockholders clear proof of voluntary and intelligent ratification is indispensable. Another and a most important element in the law bearing on this matter is that ratification by non-action or alleged acquiescence can "never be invoked to accomplish a fraud on innocent shareholders or to bring about an inequitable result" (*Thomas* vs. *Brownsville, &c., Ry. Co.*, 1 *McCrary*, 392).

It cannot be contended that any such ratification of the stock dividend of 1881, as is called for by these requirements of the law, has ever been made

by the common stockholders. The answer of the Directors to Mr. Baring-Wells' first bill avers that the alleged ratification took place at the "regular annual meeting of the stockholders" held on the 20th day of June. The meeting is said to have been "duly notified." And what business could be properly transacted at such a meeting? The by-laws say that the annual meeting is for "the election of Directors" and indicate no other business for transaction at such a meeting. They provide, however, that the Directors may call special meetings for the transaction of other business, and that the Secretary "shall state in the call the object of such meeting, and the business thereof shall be confined to the objects so stated." These by-laws were adopted at the annual meeting of the stockholders on the 20th of June, 1881. Taking the two provisions together, it is quite clear that no business out of the ordinary course can be properly transacted at *any* meeting of stockholders, unless it has been previously brought to the attention of the stockholders, with due notification of the time and place of holding the meeting, and its publication in one or more newspapers thirty days previous to the meeting.

So plain is it that nothing but the election of Directors and mere routine business could be lawfully acted upon at the annual meeting, without prior notice of thirty days to all the stockholders, that on the 21st day of June, 1886, when the Directors were for the first time confronted by the fact that there were common stockholders who understood their rights and possessed the means of asserting them in the courts, the Directors amended their by-laws so

that the first section of Article II. now reads: "For the election of Directors *and the transaction of such other business as may be brought before it.*" These italicized words were inserted for the express purpose of avoiding the conclusion, which attaches to Article III., that no important business shall be transacted at any meeting of stockholders without previous specific notice to all stockholders of the business in contemplation.

The annual meeting, then, of June 20th, 1881, might have been duly "notified," but beyond the choice of Directors and the transaction of the ordinary formal business, that meeting could do nothing without a previous thirty days' notice to all the stockholders. Now, what do these Directors admit? That without any such notice they submitted to the annual meeting in question a proposition to divide among the preferred stockholders $470,560 of preferred stock, or $20,650 in excess of the total authorized preferred stock of the Company, and that the common stockholders "approved and ratified it." Now, it may be safely asserted that even if such an act were capable of ratification under any circumstances whatever, it never could have been lawfully ratified by its clandestine submission to an annual meeting that had no authority to consider it. I say *clandestine*, for not only was no notice given of the intention to make this extraordinary dividend, *but in the annual report of December*, 1881, *the Directors fail to communicate the fact to the stockholders.*

The only source from which the stockholders can derive any knowledge of what the corporation is

doing is, of course, their printed annual report, a copy of which is sent to every registered stockholder. The annual report of the Directors of the St. Paul and Duluth Railroad for 1881 is before me. It is a document of thirty octavo pages. It was submitted to the stockholders for their "information." It is full of very minute "information," indeed. It gives whole pages to particulars and statistics of the Land Department, absolutely bristling with figures and tables of figures. But it has not one word to tell about the great grab—not one syllable, not one numeral, alluding or relating in any manner to the extraordinary fact that the Directors had distributed among the preferred stockholders nearly half a million of cancelled preferred stock, with voting power, when the charter of the Company expressly states that when preferred stock was once used in the purchase of lands, and thus converted into lands, its voting power should cease, and the stock should, in fact, be annihilated as well as formally cancelled. Worse than this. Not only is there not a word said about this singularly profitable "divide," but an intimation is thrown out at the very end of the report that excludes the idea of there having been any dividend whatever. It expresses the hope that when the "repairs and improvements suggested are completed the stockholders will receive a more substantial return for the money they have invested than the management have heretofore been able to make."

What stockholders?

The *common* stockholders? No. The stockholders generally. Here is not only a *suppressio*

veri, but a most palpable *suggestio falsi*. It would not have answered to state a *dividend* of $470,560 to the preferred stockholders in the same report which stated a floating debt of $700,000 for repairs and replacements, and the imposition of a permanent debt of $50,000 a year on the *common stockholders alone*.

Why did the report of December, 1881, withhold and conceal the all important fact that this gratuitous distribution of cancelled preferred stock had taken place, that it was a very substantial return to the preferred stockholders for their money invested, and that the common stockholders had not only ratified in the handsomest manner this resurrection of dead and buried preferred stock, but had consented to be saddled besides with an annual debt of $50,000, and 7 per cent. on $470,000, in order to encourage the preferred stockholders in the perpetration of similar outrages in the future.

If there had been any such "ratification," as is pretended, would the annual report have been silent? And when that report is so minute in its statements as to mention the fact that its capital stock had been impaired by *fire* to the extent of *sixteen* dollars, for what *honest* purpose could it have suppressed the vital fact that the preferred stockholders had imposed on the corporation the burden of redeeming a *second time* the very same stock which it had already redeemed by its conversion into its very best lands—redeemed and cancelled and annihilated. No reissue of that stock was possible, except by a fraud on the corporation, the common stockholders and the public.

Nothing more need be said in regard to the al-

leged ratification of this cancelled stock. Its reissue was unlawful and void, and incapable of ratification, even if the common stockholders with an intelligent knowledge of the fact, and of their legal and equitable rights, had undertaken to ratify it. Three objections existed to it, any one of which was fatal: 1. It purported to be a dividend, and was illegal from being made of capital stock. 2. It was a fraud on the common stockholders, because it was a reissue of stock with voting power, when it was expressly agreed that the preferred stock should lose its voting power, and be cancelled after its use or conversion in the purchase of lands. 3. It was a fraud on the public, because it assumed to rehabilitate a satisfied mortgage lien and make it a valid incumbrance on the remaining property of the corporation after it had been fully satisfied out of the whole property originally mortgaged. It is the case precisely of a mortgagee of two houses satisfying half his mortgage out of one of the houses, and then selling his satisfaction piece on the representation that it was a valid mortgage on the second house.

Apply now to this transaction the principles laid down in the text books. Their statement by Morawetz already cited is clear and explicit. When an act of Directors is prohibited by statute, prohibited by charter, or prohibited by common law, it is a void act, and no alleged ratification by stockholders can cure its illegality. In what has gone before, I think, it is established that the attempt to convert a satisfaction piece into a new mortgage is *malum in se*, both as regards the common stockholders and the corporation.

Now, let us ascertain what the Statutes of Minnesota have to say in this regard, and in the light of those statutes contemplate the distribution of cancelled stock among the preferred stockholders. I quote from the General Statutes of Minnesota, the edition of 1878, Section 81 of the Chapter regulating Railroads:

> The diversion of the corporate property to other objects than those specified in the articles and notices published as aforesaid (if any person is injured thereby), the declaring of dividends *when the profits are insufficient to pay the same, the payment of dividends when the funds remaining will not meet the liabilities of the corporation*, any wilful failure to comply with the articles of incorporation, or any intentional deception of the public or individuals in relation to their means or liabilities, are criminal offences, and persons guity of any of them may be indicted, and, on conviction, shall be punished by a fine of not more than $5,000, or by imprisonment in the State prison not more than three years, or both such fine and imprisonment, in the discretion of the Court.

Now, in 1881 there were no "profits" from any source in the hands of the Directors to pay any dividend whatever. The Directors not only had no "funds" to pay a dividend, but they had no funds whatever to pay some $700,000 of floating liabilities. Under those circumstances the Directors voted a dividend of 10 per cent. to the preferred stock, and borrowed a million of dollars which they imposed on the common stockholders only, to pay debts of the corporation which were a proper charge on its earnings, and a charge which the corporation now says, by its words as well as by its acts, can be paid from net earnings only.

So much for this 10 per cent. dividend of 1881 in its relation to the statute. The corporation is com-

pelled to admit that it had no "profits" from which to pay its dividend, as long as it had no "funds" from which to pay its "liabilities." The corporation is also compelled to admit that under the pretence of dividing "net profits" it distributed among the preferred stockholders some $470,000 of cancelled stock that was found in the custody of the trustees of the land grant.

It will be seen from the certificate that we copy below, forming part of the articles of association required to be filed in the office of the Secretary of the State of Minnesota, and by being so filed made a substantive portion of the charter of the St. Paul and Duluth Railroad Company, that when preferred stock came into the hands of the trustees of the land grant by its conversion into land, its voting powers terminated, and it could never be revived in their hands or in the hands of any third party as a valid lien on the property of the corporation.

EXTRACT FROM THE CHARTER.

The said "The St. Paul and Duluth Railroad Company," in pursuance of the provisions of the statute aforesaid, does hereby certify:

FIRST.—That said new organization was duly formed on the twenty-seventh day of June, A.D. 1877.

SECOND.—That the corporate name adopted by the said organization is the "St. Paul and Duluth Railroad Company."

THIRD.—That the amount of its capital stock is one hundred and twenty thousand (120,000) shares of one hundred dollars ($100) each, making the total amount thereof twelve million dollars ($12,000,000), of which sixty thousand (60,000) shares are preferred stock allowed to be used in the purchase of and in payment for lands of said company, as in said agreement in that

behalf provided, *each share thereof until so converted or used in such purchase of land to be entitled to one* (1) *vote in the election of Directors and in other proceedings and meetings of stockholders*, and sixty thousand (60,000) shares are common stock, every three shares of which is to be entitled to one vote. That of said preferred stock twenty-eight thousand five hundred and fourteen (28,514) shares have this day been issued, and thirty-one thousand four hundred and eighty-six (31,486) shares remain unissued.

That none of said common stock has been issued.

FOURTH.—The names of the general officers of said corporation are as follows, to wit:

John P. Ilsley, President.
William H. Rhawn, Vice-President.
Thomas M. Davis, Secretary and Treasurer.
John H. Dingee. Jr., Assistant Secretary.

FIFTH.—The number of Directors of said Company is nine (9), and the names of the present Directors thereof are John P. Ilsley, William H. Rhawn, Edwin M. Lewis, George Whitney, Edward A. Rollins, Frederick R. Shelton, James Smith, Jr., William Dawson and Charles H. Graves, all of which the said corporation has caused to be certified by this presents by its President and Secretary under its corporate seal hereto affixed this twenty-seventh day of June, A.D. 1877, at the City of Saint Paul in said State.

ST. PAUL AND DULUTH RAILROAD COMPANY,
[CORPORATE SEAL.] By JOHN P. ILSLEY,
President.

Attest:
THOS. M. DAVIS,
Secretary.

Two positions I now assume to be demonstrated beyond question. One is that the stock dividends in controversy were prohibited by the common law, by the statutes, and by the charter of the Company. The second is, that there was no ratification in fact by the stockholders, and that if the stockholders had attempted any ratification it was beyond their power.

One question remains, perhaps, beyond these. Could a void act be rendered valid by lapse of time, during which no action has been brought, no protest filed, and, if you please, no objection started by the aggrieved stockholders? In other words, can a void act be confirmed and validated by alleged laches?

Now, I will not pretend to affirm that there are not cases in which acts absolutely unlawful, and therefore absolutely void, may have been acquiesced in, condoned, and to that extent so confirmed, that a person aggrieved by them may have forfeited all his equities in a bill for relief and indemnity. As at present advised, I cannot conceive of such a case; but I do not contend that such a case might not occur. But to be thrown out of a court of equity on the ground of laches, a suitor must be proved guilty of inexcusable delay in presenting his case. The acquiescence and condonation must be shown to have been voluntary. What the law calls for is a negligent delay, or a delay that does not admit of explanation or excuse. Neither equity nor law favors a suitor who sleeps on his rights, who is not vigilant in asserting them, or who lies by to see whether or not something may turn up which may render the unlawful act advantageous to him. But in this case no such questions can arise. The act complained of is one that could not by any possibility have been to the advantage of the corporation or the common stockholder. It was clearly his interest to complain of it as soon as it came to his knowledge, without any delay whatever, and the first time it so came to his knowledge that he could base any legal or equitable rights upon it was when the

Directors were compelled to give some explanation of the circumstances in their answer to the first bill of Mr. Baring-Wells. Then, for the first time, the common stockholders obtained the information necessary to enable them to understand their rights, and to litigate for their protection. Though I had been for more than a year examining the questions involved in this controversy, from the ingenious devices with which the Directors had covered their tracks, and from the bold inveracity with which they had explained these transactions in the public prints, I was entirely deceived as to the real situation until I had studied, with considerable attention and assiduity, not only the facts set up in that answer, but the law that is applicable to those facts.

In this case it is to be especially noted that the distribution of the cancelled stock among the preferred stockholders, on the pretence of its being a dividend to reimburse them for their money expended in improvements and additions to the road, is an act that was in every aspect injurious both to the common stockholders and to the corporation. It was a great and obvious injury to both, in every form in which it could be presented. It is impossible, therefore, to attribute laches to either on the ground that either had enjoyed the benefit of the transaction of which the common stockholders complain. Indeed, upon the ground on which the Supreme Court of the United States decided the case of the Pacific R.R. Co. *vs.* Missouri Pacific R.R. Co. (111 U. S., 505), even the "knowledge by helpless stockholders of the fraudulent acts of their Directors" would not charge them with acquiescence, condonation or laches,

when their only opportunity of obtaining justice depended on their engaging in one of those "gigantic controversies" which an individual seeking redress is compelled to wage at his own charge against a Board of Directors who litigate at the expense of the corporation.

The next step in our undertaking is to show the manner in which the Trustees after having thus built up the property by its earnings, and invested in it a million of borrowed money at the charge of the common stockholders and paying themselves nominally from the profits of the railroad and the land grant a sum now amounting to nearly three millions of dollars—counselled and urged the preferred stockholders to vote themselves substantially three-fifths of the entire property belonging to the common stockholders, without giving them one dollar of consideration. At the end of nine years, in which the preferred stockholders, whose equities are no greater than those of the common stockholders, have neither applied the proceeds of the land grant to the extinguishment of the lien nor paid one dollar of dividend in any manner or form to the common stockholders —the Directors urged the passage of a resolution which, in justification of the comments which I propose to make on it, I here reprint, with the urgent letter of the Vice-President for the proxies which he had been in the habit of using for the "ratifications" to which I have had occasion to allude. The preferred stockholders had sold out their common stock once too often. In their active efforts to recover it they had run up the stock to 67, and it became necessary to adopt some very decisive measure to depress

it again into the twenties that they might come into the ownership of the property again for about a million of dollars. To accomplish this result it was of course indispensable to present an apparent inducement, and so insidiously was the scheme developed that a large number of common stockholders failed to see its ruinous consequences.

PHILADELPHIA, May 19th, 1886.

To the Stockholders of the
Saint Paul and Duluth Railroad Company.

The Annual Meeting of the Stockholders of the Saint Paul and Duluth Railroad Company will be held at the office of the Company, in Saint Paul, on Monday, June 21st, next, at 12 o'clock, for the election of Directors, and for the consideration of a proposed temporary change in the application of the net income, and of the reduction of grades, the building of new shops, the enlargement of St. Paul terminals, building line to and securing terminals in Minneapolis, building line to Minnesota Transfer, building new fencing along the railroad, and such other business as may come before the meeting. The proposed change in the application of the net income is submitted by the Board of Directors in the accompanying notice of the 12th inst. from the Secretary; and a statement of the improvements made during the past year, and of those now in progress and required in the ensuing year, will be found in the Annual Report for 1885, copies of which are now being mailed to the stockholders.

The measures proposed are of the highest importance to the welfare of the Company, and such stockholders as do not expect to be present at the meeting should not fail to be represented by proxy. Proxies will be received by the undersigned as heretofore, and where unaccompanied by other specific instructions, will be voted in favor of the several propositions unanimously submitted by the Board of Directors.

In appointing proxies it is requested that the accompanying form be used, by duly executing the same before witness and forwarding it by mail, without delay.

Respectfully,

WILLIAM H. RHAWN.

KNOW ALL MEN BY THESE PRESENTS, That I, , of , do hereby constitute and appoint William H. Rhawn, of Philadelphia; Charles D. Drake, of Washington; James J. Hill and William H. Fisher, of St. Paul; or any one of them, to be my substitute, attorney and proxy for me, and in my name and behalf to vote, act for and represent me as a stockholder, at a meeting of the stockholders of the SAINT PAUL AND DULUTH RAILROAD COMPANY, to be held at the office of the Company in St. Paul, on the 21st day of June, 1886, or at any adjournment thereof, as fully and effectually as I might or could do if personally present, hereby ratifying and confirming all lawful acts done in my behalf by virtue hereof.

Witness, &c.

ST. PAUL AND DULUTH RAILROAD COMPANY.

OFFICE OF THE SECRETARY,
ST. PAUL, Minn., May 12th, 1886.

To the Stockholders of the
St. Paul and Duluth Railroad Company:

The following resolution, adopted by the Board of Directors of the St. Paul and Duluth Railroad Company, at a meeting duly called, held this day, and at which a quorum were present, will be presented to the stockholders at the annual meeting, to be held in this city on the 21st day of June next, for their approval or rejection:

Whereas, In order to enable this Company more efficiently to meet competition and the steadily increasing demands of business, it is, in the judgment of this Board, desirable that a temporary change should be made in the application of the net income of the Company, as said application is prescribed in the "Plan of Sale, Purchase and Reorganization," finally effected June 27th, 1877, and that the change should be such as not to be detrimental to either class of the stock of the Company; and

Whereas, It appears that not less than half a million dollars will be needed to make the improvements suggested in the annual report of the Board for the year 1885, and which are, in the Board's opinion, highly important for the interest of the Company; therefore,

Resolved, That at the meeting of the stockholders of this company, to be held on the 21st of the ensuing month of June, the stockholders be requested to vote on the adoption of the following changes in said "Plan of Sale, Purchase and Reorganization," of which notice shall be given in the newspapers in St. Paul, New York and Philadelphia, to wit:

First.—The Board of Directors shall have authority to suspend the purchase or drawing of preferred stock, and to apply the net proceeds from stumpage and the sales of lands, not required in paying dividends upon preferred stock, to such improvements, additions and betterments of and to the road and its equipment, as they shall deem necessary for the full and efficient operation of the road.

Second.—The Board shall also have power to increase the dividends upon the common stock to seven (7) per cent. whenever the net earnings of the railroad shall be found to warrant it.

Third.—Any surplus of net earnings of the railroad, which mayremain after paying a dividend of seven (7) per cent. upon the preferred stock, and a like dividend upon the common stock, shall be divided equally upon the two classes of stock.

Fourth.—Such suspension of the application of the net income shall continue only so long as it may be needed to accomplish the necessary improvements, additions and betterments.

By order of the Board of Directors,

PHILIP S. HARRIS,
Secretary.

For convenience I shall refer to this as the Bamboozling Resolution. There is no other word in the English language that so fittingly describes it. The dictionary definition of "bamboozle" is to "deceive"—to "play low tricks upon any one." There are numerous convertible terms for the act of bamboozling. One of them is "gilding the pill"—such in the present case as raising the dividend on common stock from six per cent. to seven, without paying the six, and without any expressed intention of

paying it. Another synonym is, "to throw dust into the eyes." This is illustrated by the manner in which the Trustees attempted to disguise their real object in such a mass of "verbiage" that when they undertake to explain the meaning (as they *wish* it to be understood) they eliminate nineteen words out of twenty as mere wrapper or surplusage. Another phrase is, "to set a trap for one." The trap in the resolution was the assurance to the common stockholders that the disposition of the "net income" was only a disposition of the "stumpage"; whereas it was intended to cover the net income from all sources, as is shown by the actual application of the entire net income to the uses of the Company for the years 1885 and 1886. "Cogging the dice" is another equivalent, as in the present case the Trustees flatly affirmed that the proposed suspension of drawing preferred stock is only "temporary," when they make it permanent by a permanent disposition of the net earnings of the railroad in another direction, and by applying the stumpage to improvements until the Directors chosen by the preferred stockholders shall elect to apply it to the extinction of the preferred stock. Would it be possible to render any stock more permanent than the preferred stock of the St. Paul and Duluth Railroad would have been if that resolution could have been and had been lawfully passed by both classes of stockholders? Was it not knowingly "cogging the dice" to offer such an irreversible proposition as *only "temporary"?*

In the *Railroad Record* of the 10th of July, 1886, the management give their account of the proceedings at the annual meeting of stockholders on the

previous 21st of June. In this narrative they say that the "question presented to the stockholders, when divested of legal verbiage and reduced to its simplest terms, was, 'Shall the Directors have authority to *temporarily* apply the proceeds of sales of lands and stumpage to improvements upon the property; (2) to increase dividends upon common stock to 7 per cent.; and (3) to divide the remaining surplus earnings of the railroad equally upon both classes of stock?'"

(1.) With regard to the first proposition, the *temporary* application of the proceeds of the land grant to improvements on the property might not have been impossible, though those proceeds were lawfully mortgaged for the liquidation of debts already incurred in the original construction of the road. To apply them permanently to new improvements, therefore, would have been grossly unjust to the preferred stockholders, who had secured by charter the annual application of the surplus from this source, when amounting to $10,000, to the liquidation of the preferred stock. To make a different disposition, even temporarily, of this surplus, indeed would have been a grievous wrong to the preferred stockholders, though to the common stockholders, perhaps, not altogether objectionable. The trouble was that the application was permanent.

(2.) The second proposition is utterly fallacious. It purports to give the Directors the power to "increase" the dividend of the common stockholders to 7 per cent., and to leave the power of giving or withholding any dividend for an unlimited period in the hands of Directors elected solely by the preferred

stockholders. Everything beyond 7 per cent. per annum was already secured by the charter to the common stockholders. The proposition, therefore, was simply a fraudulent device to rob the common stockholder under the pretense of *increasing* his dividend. So far from *increasing* his dividend, the proposition was to *diminish* his dividend to the full extent of three-fifths of the net income from all sources after the payment of fixed charges of 7 per cent on both stocks. The dividend to which the common stockholder is entitled is his 6 per cent. and the application of the surplus to the retirement of the preferred stock, which is the payment of so much additional dividend in another form.

(3.) The third clause contains the milk of the cocoanut. Its object was to inveigle the common stockholders into the commission of an act of egregious folly. The effect of its lawful adoption would have been to add to the 7 per cent. already enjoyed by the preferred stockholders (and which they had received to the amount of two million and a half of dollars) more than one-half of the surplus earnings of the railroad now applicable to the extinction of their stock; and by making this diversion of the surplus earnings to establish the preferred stock, with its vote of three to one over the common stock, forever. In its operation it would be substantially a conveyance without consideration by the common stockholders to the preferred of more than half the property of the Company, subject to the payment of certain fixed charges. Stripped of all legal or illegal verbiage, this was the purpose and the only purpose of the Bamboozling Resolution of the 12th of May.

No explanation whatever was given by the Trustees of the grounds on which they claimed this division of the surplus earnings of the railroad with the preferred stockholders ; nothing of the kind could possibly have been suggested by their deed of trust. And yet it was clearly a case calling for the most explicit explanations, and from the fiduciary relation of the Trustees to the common stockholders, making the slightest misrepresentation of facts in the highest degree reprehensible.

But the Trustees assured the common stockholders that their interests were the same as those of the preferred stockholders, which was not true.

They assured them further that the preferred stockholders had not a dollar of interest in the adoption of the propositions. Nothing could have been more untrue.

They said that the only possible adverse effect on the common stockholders was that the adoption of the resolution might "postpone" the retirement of the preferred stock—a retirement that it postponed to the Greek Kalends.

They insisted that the resolution had not "one single element of benefit" to the preferred stockholders except this "postponement"—a postponement that could have been lawfully continued till the last acre of the land grant had been sold, and the last dollar from that source applicable to "retirement" exhausted.

They declared in the most gushing style that the resolution was so "fair" that it offered no reasonable ground of opposition—fair as the whited sepulchre, full of dead men's bones.

They insisted strenuously that as "their" seven per cent. was secure they had no object in view but to improve the property in the interest of the common stockholders—as if voting themselves the fee of three-fifths of the whole property was no object at all.

They averred that if their resolution should be adopted the common stockholders would stand in precisely the same position that they did before, except that they would receive increased dividends. In other words, a mortgagor making over to his mortgagee in possession three-fifths of the profits above a rent certain would stand in precisely the same position that he did when beyond a stipulated rent the profits were altogether his own.

They solemnly protested that the whole scheme was so greatly to the "advantage" of the common stockholders that "they should all heartily favor it"—jump at it—in fact, cry for it—the great advantage being that which the traveler derived from his bargain with Captain Macheath to give him his pocketbook if the captain would allow him to keep his watch.

They were painfully impressed with the fact that the defeat of the resolution would compel them to postpone dividends on the common stock to the "dim and distant future," so they told the common stockholders that it was impossible to pay them any dividend because the twelve protestants had put it out of their power to do so; and when one of the protestants respectfully inquired how that could be, the Vice-President respectfully declined to "enter into the discussion."

They said that by the methods prescribed by the plan it would take "forty or fifty years" to liquidate the preferred stock, and that only two or three per cent. a year could be liquidated; while it is capable of demonstration, and is demonstrated by Mr. J. P. Ilsley, in his letter to the common stockholders, that the preferred stock, on the basis of the earnings of 1885, can be retired in ten years and six per cent. paid to the common stockholders every year.

Now, go back to the propositions "divested of legal verbiage," and read them in the light of all these affirmations, recommendations and protestations of the Trustees. What is there in them of any substantial interest except the donation to the preferred stockholders of more than half the surplus income of the railroad? What right have the *Trustees* to make such a proposition? What possible claim have the preferred stockholders on the generosity of the common stockholders? Is it because they have persistently refused to live up to their contract? Is it because they have over-issued preferred stock illegally and distributed it among themselves? Is it because they have done the same with cancelled stock to which they could not possibly give a legal resurrection? Is it because they have skinned the resources of the Company to the last farthing to pay themselves seven per cent. dividends when there were no profits to authorize such payments, and ten and a half per cent. dividend when their utmost limit was seven per cent.? Is it because the common stockholders are now paying seven per cent. on $5,736,970 of preferred stock, when, if the Trustees had done their duty, the preferred stock legally out-

standing to-day would have been very much less than four millions of dollars? For which of these reasons ought the common stockholders to give away fifty-five ninety-fifths of their property? Will the Trustees kindly give the *scintilla* of a reason for their proposition to give this property to the preferred stockholders? Giving the income forever is giving the property—is it not?

But we need not pursue these inquiries—there are other matters which call for our consideration. What has occurred since the defeat of the Bamboozling Resolution, and what is the present status of the corporation with regard to the two classes of stockholders?

It was at one time seriously asserted by a legal adviser of the Company, and by the management in a semi-official way, that the preferred stock could not be retired, but after the publication of the letter of Mr. Ilsley to the common stockholders, the pamphlet of "a mere anonymous newspaper scribbler" (June 10th, 1886), and the later exposition of the "crooked by-ways and slippery highways, traversed by the Directors of the St. Paul and Duluth Railroad Company, Trustee," by a common stockholder (December 20th, 1886), the assumption has been virtually abandoned by intelligent persons. Indeed it is difficult to imagine how it should be otherwise, with the following provision engraved on every certificate of preferred stock that the Company has ever issued, or ever can issue, in accordance with the statutes of Minnesota:

"This stock is entitled to receive dividends payable semi-annually . . equal to the net income of the Company from all sources,

but not to exceed seven per cent. per annum, and to be made payable first out of the net profits of the railroad, and in case of any deficiency therefrom, the same to be made up, if possible, out of the net income from stumpage and the sales of lands. When not required to make up the dividends on the preferred stock, the net proceeds from lands and stumpage are to be applied at the expiration of each year (provided the same amount to at least $10,000) to the purchase of the preferred stock, and if said stock be below par on the market, proposals are to be invited by advertising in the newspapers of New York, Philadelphia and St. Paul, and if the same cannot be bought at par or under, drawings are to be had, as is usual in the operation of sinking funds."

Now and then some preferred stockholder, in a frantic interval, protests in the financial journals that he *will* not be retired, and that nobody *shall* retire him; and once at least the Philadelphia management in their local organ have given out that the "impression abroad" of this "retirability" is a false impression; "that no such stock has been retired," and that the probability of its retirement is so "remote" that it ought not to affect its market value as a permanent seven per cent. stock. At any rate, they say its "retirement" would require forty or fifty years, as only some three per cent. a year could probably be devoted to it. Now it is obvious to any one who reads the above cited provision on the certificate that it is the duty of the corporation to appropriate the proceeds of the land grant to the liquidation of the preferred stock, and that if it is for the advantage of the corporation the Directors are bound to sell the land and stumpage as soon as it can be disposed of and remove from the property a very disadvantageous and very expensive incumbrance. And there is no reason in the world why that incumbrance should

not be removed in the course of the next twelve months.

The very best thing for the corporation that can possibly be done with its surplus net income is to apply every dollar of it to the reduction of the preferred stock; or, in other words, to apply it according to the provisions of the agreement. If the Directors do their duty they will so apply it. They have no discretion to do otherwise. They have in the most reprehensible manner evaded and defrauded their trust hitherto, and with what consequences we may learn from the latest manifestoes of the management in the *Railroad Record* of the 11th and 25th of March.

The first in date of these articles is intended to show that the business of the St. Paul and Duluth is so enormous and so rapidly increasing that an expenditure is called for in the annual report of December, 1886 (not yet printed), of at least two million of dollars. Last year it was $500,000, "not all at once, but extended over two or three years"; but it turned out to be $568,315.87, beside $100,000 or more tucked away under operating expenses. All this was expended from net earnings "otherwise payable" to the common stockholders, 6 per cent. in cash, and the residue in the retirement of preferred stock, which is a 7 per cent. burden on the corporation, when money is obtainable for all its uses at 4½ per cent. Of this two million it would seem $1,200,000 is required for new equipment, because the corporation has been compelled to pay $58,606.28 during the past year for car and locomotive hire. Let us see. Five per cent. on $1,200,000 is $60,000. So

to avoid an expense of $58,606.28 these extraordinary financiers would expend twelve hundred thousand dollars of net earnings, instead of applying them to the retirement of preferred stock on which the corporation is paying $84,000 a year. Add to this the loss by wear and tear on the new equipment, and its depreciation by exposure to the weather when unemployed, which must amount to at least ten per cent., with the taxes besides, and we have a charge on the corporation of $200,000 a year at the very lowest calculation in order to "get rid of the surplus" and avoid the payment of any dividend on the common stock. Considering the amount of business contributed by the Manitoba Road, which, of course, furnishes all its own cars, it is clear enough that the expenditure of $1,200,000 in equipment would be an act of great folly under any circumstances, and particularly under the circumstances to which we shall refer in another connection.

It is the old story, with no variations. Since we can no longer deceive the common stockholders by delusive book-keeping, we must try some other way of keeping them out of their own. We are doing such a rushing business and making so much money that we are too poor to execute our trust so far as the common stockholders are concerned. "Between stockholders," they say in these very words, "who want all the land income applied to the reduction of the preferred stock [a seven per cent. liability] and those who want all improvements stopped and dividends to be paid at once on the common stock [as they may be paid without stopping *all* improvements] and the urgent necessities of the road for means to

retain and handle its increasing traffic, in the face of existing and threatened competition, the management have a difficult problem to solve, requiring all of their wisdom and courage and calling for the utmost consideration and forbearance on the part of the stockholders interested in the ultimate success of the road as an independent line."

What stockholders are to "consider" and "forbear"? We know how the preferred stockholders have shown "consideration" and "forbearance" towards the corporation and the common stockholders. When the corporation was at its sorest need, they robbed it of $470,000 of its cancelled stock, and have been robbing it of $57,000 a year on it ever since. When the corporation wanted $700,000 to pay off its floating debt, they did not pay it off with the earnings as they ought to have done, but they saddled the impoverished corporation with a permanent debt on that account of a million of dollars that they might divide its earnings among themselves. Again, when in 1884 they found, or said they found, these earnings insufficient to pay more than 3½ per cent., which should have been the extreme limit of the dividend that year, they paid themselves 7 per cent. more, or $350,000 in the cancelled stock of the company and $187,000 in cash. This division of preferred stock I have already shown to be fraudulent and void. A pretty lot—these gentlemen—to call on the corporation and the common stockholders for "forbearance" and "consideration" because they have got so much money that they cannot get rid of it without appropriating a couple of millions in

such a way as to postpone all relief from the incubus of a 7 per cent. debt.

If the preferred stockholders wish to do their duty by the corporation—as well as the common stockholders—they will apply the accruing two millions in the mode prescribed by their trust, and if they want money for the improvements they speak of—borrow it on the credit of the Company at 5 per cent., and save the Company $40,000 a year.

But let us come to the article of March 25th. A change has come over the management. All this extraordinary rush of business that was to accrue to the St. Paul and Duluth and call for this extraordinary expenditure of two millions of dollars—$1,200,000 for equipment alone—is a delusion. The enormous business is to be for one year only. The surveying fiends are in the woods and the swamps once more. There is authoritative information by a "despatch" from St. Paul, that there are to be three new railroads—"powerful" railroads—constructed right away, that are bound to take all the profits from the St. Paul and Duluth, and reduce it to the condition which the directors so earnestly desire, when it will be able, *bona fide*, only to earn 7 per cent. on its preferred stock by land-grant receipts and railroad receipts together. That would be a bad day for the corporation, but just the thing for the preferred stockholders and *their* directors, who are only anxious that the whole profits from all sources should not exceed 7 per cent. Accomplish that, and the directors would be happy.

Of these powerful competitors, one line runs from St. Paul to the "Soo"—and does not come within

I do not know how many miles of Duluth. Another "surveying party" of the Chicago, Burlington and Northern laid out a line last winter running through an impassable swamp of thirty continuous miles, and calling for bridges over eleven rivers. It will take them some time to drive the piles after acquiring the right of way. It will spend some money, and without a land grant will find some difficulty in competing advantageously with an old established road that has a land grant large enough to pay off all its preferred stock, and leave a road with no incumbrance but a million and a half of 5 per cent. bonds. As to the Manitoba Road, it will, of course, build its 79 miles from Hinckley to Duluth the moment it finds its interest in doing so, and not before. And that interest will not arise as long as it has the opportunity of buying the ownership stock of the St. Paul and Duluth at present market prices. As for "surveying parties," there have been surveying parties "in the field" every year for the last forty years to parallel the line between Boston and New York, and yet the N. Y., N. H. & Hartford and the Boston and Albany railroads still hold their own against all comers, and are both something above par, in spite of "powerful" competition. And if you have studied the map, you may have noticed that there is no "Sound" between St. Paul and Duluth, and that the only water-way from one to the other, traverses the Atlantic Ocean and the Great Lakes. That is quite another thing from merely rounding Cape Cod.

But if the danger of this pressing and ruinous competition is so imminent that the St. Paul and

Duluth is to "have the enormous business *this year* for which it has been making such extensive preparations," but that *hereafter* it is to "have no chance in competition with the powerful companies mentioned" —what supreme folly it is to squander two millions more after the millions that have already been squandered in providing means for doing an "enormous" business for one year only! Would not the most ordinary business capacity grasp the fact that the only thing to be done under such circumstances is to curtail every expenditure *at once*, and apply the million of dollars that will be earned this year to saving $70,000 a year by the retirement of that amount of preferred stock? If we are in danger of losing our income, is it not the only policy to diminish our expenditures? This would be the policy of merely ordinary financiers, and we certainly can expect nothing worse from gentlemen with such claims to financial distinction as are put forward for the Directors of the St. Paul and Duluth.

We must linger one moment longer on this question of competitive lines. The management say: "However great the future traffic between St. Paul and Duluth may at some time in the future be, it will not now sustain one additional line, to say nothing of three. The St. Paul and Duluth has *never yet* been able to pay a dividend on its common stock; in fact, it has paid its dividends on its preferred stock largely from its land income." Worse than that. It has paid dividends on its preferred stock which were never earned, and has impaired its ability to earn dividends on the common stock by saddling the corporation with $820,000 of void and

fraudulent stock, and is paying 7 per cent. dividends on it, to the tune of $57,400 a year. And yet for all that it has expended within two years a million of dollars, which, if expended according to the terms of the trust, would be a million of dollars dividend to the common stockholders.

To summarize the situation, the corporation has never been able to pay a dividend on its common stock (because all the money has been spent in making preparations for future business), and now notwithstanding its "extensive preparations" it does not stand much chance of getting the business after this year. It has not been able to pay a dividend yet, because the money was wanted for necessary improvements. It will not be able to pay dividends hereafter because the necessary improvements turn out to be of no permanent use. This is the purport of the last manifesto of the management. If well founded, it certainly shows that the money which ought to have been used in retiring preferred stock, and in paying dividends on the common stock, as required by the trust, has been literally money thrown away.

It is a singular fact that one of the arguments used by the management to induce the acceptance of the Bamboozling Resolution was that "the temporary suspension of the drawing or purchase of preferred stock" would enable the Directors to "understand" the plan better, and ascertain its "legal possibilities" and the "best disposition to make of the surplus income." They had been acting under it for ten years, but they were so slow of understanding that they wanted the plan "sus-

pended" indefinitely in order to find out what it meant.

Now, the plan is not so very difficult to understand. It creates a corporation which at the same time operates a railroad and undertakes to execute a trust. There is nothing very complex about that. It is to run the railroad on business principles, and execute its trust on the ordinary understanding of fiduciary relations. One class of stockholders is entrusted with the duty of electing the Directors who are to represent the corporation and execute the trust. When elected they owe their primary allegiance to the *corporation* and not to the men who elected them. They are to consult and act always in the interest of the corporation and not of the preferred stockholders, or even of the public. The State has agents to look after its own special relations to the railroad, and to see that its bounty to the road is not squandered or misapplied.

The corporation finds when entering on its charge that the railroad is encumbered with a class of securities bearing a heavy rate of what is practically interest, for the liquidation of which a large amount of real estate has been assigned and set apart. So strictly is this fund dedicated to this purpose that not even a $10,000 balance accruing at the end of a fiscal year can be lawfully withheld from it. Now, what is the duty of the corporation under these circumstances? It is vested with no discretion. The precise terms of the trust say that this money is to be applied in one way and in no other. Can the corporation lawfully apply this money to its own use

which it expressly holds for the use of a class of beneficiaries?

The corporation is supposed to manage its affairs in its own interests, on the same principles which govern the action of an intelligent person. Would any sane person managing his own property allow a seven per cent. obligation to remain upon it one moment after he was able to replace it with a five per cent. obligation? What would any person of ordinary sagacity do with his accruing cash under these conditions? Apply it to the withdrawal of his seven per cent. debts when he could hire money at five per cent., would he not?

The nine managers of the St. Paul and Duluth have gone on for years financiering for the corporation in a manner for which a private person should be sent to an asylum of some kind or other. These eminent financiers—so eminent that they want to make each other Secretaries of the Treasury, even without consulting President Cleveland—continue to pay 7 per cent. for 4½ or 5 per cent. money. Why, the President ought to secure the service of all the nine for the Treasury, and put the Department in commission so that the country might not lose the benefit of their united and consolidated "wisdom." If they had been so installed, no doubt they would have called in all the three per cents. incontinently, and substituted without a moment's delay a re-issue of the paid and canceled seven-thirties. They would have immortalized themselves, and posterity would have been at a loss to know when the "sacred nine" were spoken of, whether the allusion was to the nine muses, or to President Cleveland's nine financiers.

For years this thing has been going on. In the last eighteen months the corporation has spent more than a million of cash applicable to the retirement of the preferred stock, and the payment of six per cent. on the common stock. They say they want to spend two millions more. In view of these expenditures the managers plead piteously for "consideration" and "forbearance" from the common stockholders. Naturally. This prayer is at once a wail of despair and a cry of *peccavi!* The Directors cannot fail to feel that it is the interest of the corporation as a railroad manager, and its duty as a trustee to both classes of stockholders, to use this accruing cash in reducing its 7 per cent. liabilities as called for by the deed of trust, and if money is wanted for equipment and construction raise it at 4½ or 5 per cent. on the abundant and constantly increasing credit of the company. There is not much "wisdom" called for to do this. A very little common honesty and common sense is alone amply sufficient. But for a corporation, with such an enormous business pressing on it, which is so much endangered by threatened competition that it is to last one year only, it would be madness to do anything else with their cash as it comes in than to apply it to the retirement of those inexorable obligations which are so unnecessarily exhaustive of the net earnings.

These preferred stockholders who delude themselves with the idea that they are the corporation—these mortgagees who undertake to vote themselves the property of the mortgagors—these creditors who propose to distribute among themselves the assets of a solvent debtor—have had the impudence to pro-

pound through their Philadelphia organ an ultimatum that deserves consideration. It is in the words following, to wit:

"The common stockholders can probably have whichever they choose: productive improvements from the proceeds of sales of land and stumpage and EARLY DIVIDENDS; or the purchase and cancellation of preferred stock * * and an INDEFINITE POSTPONEMENT OF DIVIDENDS."

This is the menace—abrupt, peremptory, brassy, brutal. The common stockholders do not propose to be gored by either horn of this dilemma. Their shortest and easiest road to dividends is to save the difference between 7 per cent. and 5 per cent. on $5,376,970 of their obligations, including among these obligations $820,000 of cancelled and void stock. This saving would amount to more than $100,000 a year, and to that extent would be a great benefit to the corporation, the common stockholders and the public. I mention the public in this connection because it is evident that every saving which diminishes the charges on the corporation enables it to offer better terms to the commercial community.

Deduct $820,000 of void certificates from the outstanding preferred stock: apply the land grant balances from 1882 to 1887, amounting to $713,472.73, to their only lawful use, the liquidation of the preferred stock; apply the net proceeds of land sales of the first two months of 1887, amounting to $142,218.27, to the same object; and there would now be legally outstanding $3,700,516.27 of valid preferred stock. The cash receipts of the last twelve months, applied as the plan requires, would largely diminish

this amount. It is not too much to say that the preferred stock lawfully outstanding on this 10th day of April could be immediately retired by the sale of three million dollars worth of the land pledged to the liquidation of this incumbrance.

We need only listen to the loud wail of the management from Philadelphia, their pleadings for forbearance, and their pious and creditable prayer for more "wisdom"—to know that they are hearing frequently from the common stockholders—who are clamorous for the lawful application of the proceeds of the land grant to the reduction of preferred stock and the lawful application of the net earnings of the railroad to the payment of dividends on the common stock. This state of things demands of the management as they formulate it, not only "wisdom"—but "courage" also. What courage? No extra courage need be prayed for to enable a man or management to do what is fair, and honest, and upright. But I will admit that any amount of courage may be wisely prayed for when the undisguised object is to evade a trust, disregard a charter and circumvent the law.

What the management tell us the common stockholders are calling for—and for resisting which they invoke the aid of courage, wisdom, consideration and forbearance—is the lawful application of the revenues of the corporation to the objects and uses prescribed by the charter. This involves as an ultimatum an immediate cash dividend to the common stockholders, and immediate retirement of preferred stock, with the fund dedicated to that purpose.

This is all the common stockholders desire, and this is what the preferred stockholders and some of